You are Hoi Lui, a management consultant leading a small team which has been commissioned to prepare a consultancy report for the Data Communications Services (DCS) Company directors to help them plan for the next three years.

DCS Company has two product areas. The largest area is the manufacture of data communications components which it mainly sells to original equipment manufacturers (OEM). The other smaller and less developed area is based on supply and support contracts for specialist IT management network systems, mainly to domestic medium-sized enterprises. You are a qualified accountant and your colleagues are Danny Leman, a company researcher, and Freddie Lithium who is a part-qualified finance professional. You and your team have collected and analysed the following information about DCS Company to help you prepare the consultancy report.

- Exhibit 1: A report on DCS Company's organisational overview, the external environment and the business model sourced and prepared by Danny Leman, your colleague
- Exhibit 2: A transcript from interview which was held between you and Java Peraya, the CEO of DCS Company.
- Exhibit 3: Summary of financial and business performance of DCS Company extracted from the Integrated Report (2012–2015) presented to you by the finance director of DCS Company
- Exhibit 4: The October board report, a recent board meeting notes which include strategic choices facing DCS Company – presented to you by the marketing manager of DCS Company
- Exhibit 5: An evaluation of alternative future strategies being considered by the DCS Company board, prepared and presented to you by your colleague, Freddie Lithium
- Exhibit 6: Minutes from the focus group meeting you held with middle management of DCS Company

Following your findings you are now starting to prepare the consultancy report and associated tasks for DCS Company.

The case requirements are included in the tasks shown below:

1 (a) From the information you have collated, draft a section of the consultancy report for the directors of DCS Company to include the following:

(i) An analysis of the industry and market which DCS Company is competing in, using an appropriate model. (15 marks)

(ii) An evaluation of the overall performance of DCS Company between 2012 and 2015 from an integrated reporting perspective. (12 marks)

Professional Skills marks are available for demonstrating evaluation skills relating to DCS Company's environment and performance. (4 marks)

Exhibit 4

The October board report for DCS Company

To:	The Board of Directors – DCS
Subject:	Strategic overview – DCS Company
From:	Jules Debrey (marketing director)
Date:	12 October 2015

Introduction:

This report is based on information obtained from all the executive directors of DCS, under several main headings. The report highlights risks, opportunities and the future outlook for DCS. It also focuses on strategy and resource allocation, highlighting a key strategic decision which the board will need to make in the near future.

Risks and opportunities: What are the specific risks and opportunities which affect DCS's ability to create value over the short, medium and long term, and how is the organisation dealing with them?

By 2014, the international market for data communication components started to saturate and decline.

For the supply and support of contracts for specialist IT network management systems, we are now finding it increasingly difficult and costly to maintain the required level of network support. It is getting harder to recruit high calibre staff to DCS. The headquarters of DCS, although a modern site, is in a geographical location which is unattractive for key personnel to relocate to. Our specialists in the systems support side of the business are currently overstretched because many key staff have been 'head hunted' or taken early retirement.

Lenders have until recently been quite willing to lend DCS additional long-term funds at competitive interest rates, but are now tightening their credit lines to the company and placing covenants on us to keep financial gearing within acceptable limits. They are also increasing their interest rates to compensate for the additional financial risk. It is unlikely that any future growth or investment can be financed from further debt and we would need to use our considerable cash reserves or utilise internally generated funds. Currently, DCS has a geared cost of equity capital of 12%.

Future outlook: What challenges and uncertainties is DCS likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?

DCS currently manufactures approximately 50% of all data communications components used in its own products. The rest of the complete components, including semiconductors and microprocessors, are bought in from two multi-national global suppliers. These suppliers have since 2006 become the key players in the market through a succession of acquisitions and mergers, where previously there were many more suppliers, all with a much smaller market share.

Recently, serious production problems have resulted from periodic component shortages from these key suppliers, creating significant delays in manufacturing, assembly and customer deliveries. One of our recently acquired OEM customers accounts for 40% of our sales in this area.

Marketing forecasts for 2016 and beyond indicate stronger growth from the supply and sales support for specialised IT management services to currently installed networks in the domestic financial sector, rather than from the manufacture of components to OEMs or for the installation of new networks to large companies. The other potential growth area is in providing cloud computing and big data analytics capability to the SME sector. Including DCS, there are currently only three companies which provide these specialist services in Prydain.

Strategy and resource allocation: Where does DCS want to go and how does it intend to get there?

As executive directors, we need an appropriate strategy for the next three to five years. On current trends we are looking at approximately a 10% year on year decline in our revenues for the next three years. At this forthcoming board meeting we need to discuss and decide on the best strategy for us as a company.

We need to decide between two strategies. Do we re-align the business to make it less reliant on the high volume, low margin components segment and re-allocate resources from the data communications segment into this higher added-value sector of network management and support? To do this we will need to further exploit technologies such as cloud computing and, in particular, big data analytics which seem to offer lower cost data storage, better understanding of consumer preferences and ability to develop more bespoke products and services. Alternatively, should we re-focus on our core capability in the data communications components manufacturing area, where we have such expertise, experience and where most of our turnover is currently generated?

Conclusions:

The DCS board should now evaluate the risks and opportunities and take a key decision. DCS also needs to consider how it will implement its chosen strategy and how it will finance it. See further information below.

Forecast tangible benefits and costs resulting from various potential scenarios

In 2015 we have estimated that the net cash contribution from the data communications components segment of the business is $1·55m and the net cash contribution from the network supply and support is $0·85m. These are after interest and tax. The expectation is that total cash flow contribution will continue to decline by about 10% each year if we do nothing.

Re-focus strategy:
We can implement this strategy by re-organising our sales and support teams, making manufacturing cost efficiencies and targeting our data communications component customers more effectively. If we are successful, we estimate that we can at least maintain the total cash contribution of DCS at the current level of $2·4m for the next three years.

Re-alignment strategy: With a re-alignment of the business towards the network supply and support segment, the net cash contribution from the communications components sector is forecast to decline by 10% per year for the following three years. This is regardless of how the net cash contribution from the network and IT systems support business is expected to grow under any of our assumptions. Forecast annual fixed costs and working capital savings from the decline in the data communications manufacturing area are expected to be $0·35m from general costs and will also result in annual carbon tax cost savings of $0·15m, giving a total saving of $500,000 per annum for the next three years (2016–18). Note that these forecast savings are independent of which growth forecast below emerges.

Table 1 below shows the projected growth in the cash flow from the network supply and support segment in the next three years; the additional fixed costs of this investment; and the savings to be made in the data communications division, should the re-alignment and additional investments take place.

Table 1: Alternative growth forecasts for DCS Company under the re-alignment strategy

Re-alignment strategy and probabilities for growth	Probability of growth materialising (%)	Forecast annual increase in cash fixed costs ($m)	Forecast annual savings from decline in data communications segment ($m)
Additional cash contribution from the network support business will grow by 25% each year for the next three years from the 2014 level	60	+0·75	–0·5
Additional cash contribution from network support business will grow by 15% each year for the next three years from the 2014 level	30	+0·45	–0·5
Additional cash contribution from network support business will grow by 10% each year for the next three years from the 2014 level	10	+0·25	–0·5